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212158Z Dec 04

UNCLAS SECTION 01 OF 02 OTTAWA 003433

SIPDIS

SENSITIVE

DEPARTMENT FOR EB/IFD, WHA/EPSC AND WHA/CAN
STATE PASS FEDERAL RESERVE BANK FOR CHUGH
STATE PASS SEC FOR JACOBS
TREASURY FOR WILBUR MONROE AND DAVID NAGOSKI

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [CA](#)

SUBJECT: BANK OF CANADA GOVERNOR IMPLICITLY ENDORSES BANK
MERGERS

REF: A. TORONTO 1986

1B. TORONTO 1386

11. (U) Bank of Canada Governor David Dodge included a pitch for bank mergers in his December 9 speech on Financial System Efficiency, emphasizing that "scale does matter" and that Canada's financial markets must compensate for their limited "size, depth and liquidity" with greater relative efficiency. Dodge, who was Deputy Minister of Finance while current Prime Minister Paul Martin was Finance Minister, is believed to closely reflect the PM's views on most issues. He pointed out that other markets, specifically the US and UK, have surpassed Canada's post-war lead in revising financial regulations, a trend reflected in the slide by Canadian banks down the scale of the world's banks. The IMF's December 20 call for clarification of the regulatory framework on bank mergers headlined the story in the business section of Ottawa's newspaper. Financial sector observers now think that the uncertainty posed by a minority government might not prevent the GOC from having to clarify its position on bank mergers (an outright ban is not a feasible option), which could open opportunities for US banks. Dodge also spoke about the need for a national securities regulator (septel).

When, not If?

12. (SBU) The final decision on bank mergers rests with the Prime Minister and Finance Minister. In 1998, Paul Martin, the then-Finance Minister, refused to approve proposed mergers between the Royal Bank of Canada (RBC) and the Bank of Montreal, and between CIBC and Toronto-Dominion Bank. Pressure has been building over the past year for a clear statement on bank mergers by Finance Minister Ralph Goodale, but his "clarification" was postponed from June to October, and is now on hold indefinitely. Claiming the need to complete consultations with bank CEOs (of which there aren't that many), Goodale has refused to indicate a possible date for the much-awaited statement. A banking insider finds the delay laughable, pointing out that GOC policy already permits mergers, and that no financial institution has requested clarification of the process. They are "horribly frustrated and the whole process is a sham."

13. (U) The is widespread agreement that Canada's biggest banks need to merge domestically in order to be globally competitive. RBC, the largest, is now ranked 50th in the world by bank asset size, behind seven U.S. banks. Four other Canadian banks are clumped between 61 and 66 in the rankings. By market capitalization, RBC is the 36th largest financial institution in the world, followed by Scotiabank at 41st.

14. (U) In the absence of Finance Ministry support for domestic mergers, Canadian banks have used some of their surplus cash to expand into the U.S. market (reftels). The years of pent-up demand make multiple merger requests likely should banks receive a green light, so the GOC is wrestling with competition concerns in the highly-concentrated industry. (Note: Current betting, should mergers be approved, is on applications for a Scotiabank merger with the Bank of Montreal; Toronto Dominion (TD) with CIBC; and possibly a union between RBC and an insurance company. However, banks have kept their plans close-hold to avoid controversy. End note.)

Mergers could open the market

15. (SBU) A contact at the Canadian Bankers' Association, speaking personally, sees the GOC's best option as permitting the mergers, which are necessary to boost Canadian banks' international competitiveness, while requiring significant divestiture of domestic branches. Sale of 300-500 branches by merging banks would open opportunities for a mid-level

Canadian bank (possibly National) and for foreign banks to expand in Canada's saturated market. HSBC has the largest foreign-bank presence in Canada, but the availability of branches nationwide is also mentioned as an opportunity for players such as Citibank, which don't have a retail presence in Canada.

16. (U) Note: U.S. banks in Canada welcome the uncertainty over mergers, which they believe provides them with a competitive edge. Institutional clients tend to become more interested in partnering with a large US bank when asked if they really want their financing from an institution that may or may not be dealing with a major merger in the near future. End note.

Lack of Majority in Parliament may not prevent movement

17. (U) Conventional wisdom has held that approval of bank mergers would be extremely unlikely in the context of a minority government and banks had been focusing their lobbying efforts on the upcoming review of the Bank Act in 2006. In October, the head of the House of Commons finance committee said "mergers between Canada's big banks and insurers are "going to happen" if the financial sector requests it, but bank-bank mergers have been more sensitive given the limited number (six) of large national banks. Although the opposition Conservative party contains an anti-big bank element, leaders such as Steven Harper and Finance Critic Monte Solberg recognize the need for financial sector efficiency.

18. (U) Solberg's position is that they would like to see bank mergers and think that "the industry and Canadians deserve" the benefits. However, the Conservative party would want to see the specific proposals and have each case considered on an issue-by-issue basis. (Comment: leaving open the possibility of objections in specific cases. End comment.) The negotiations needed to gain support from opposition parties in a minority government could, in fact, facilitate the decision by providing cover for the governing Liberal party. Governor Dodge's comments, the coverage given to the IMF statement, and the apparent willingness of the parties to work together on a range of issues in parliament may bring the merger issue back into play.

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